

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Mar 10 5 1 PM '99

CLASSIFICATION AND FEES FOR
WEIGHT-AVERAGED NONLETTER-SIZE
BUSINESS REPLY MAIL, 1999

Docket No. MC99-2

**REQUEST OF THE UNITED STATES POSTAL SERVICE
FOR A RECOMMENDED DECISION ON CLASSIFICATION AND FEES FOR
WEIGHT-AVERAGED NONLETTER-SIZE BUSINESS REPLY MAIL**

UNITED STATES POSTAL SERVICE

By Its Attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Michael T. Tidwell

475 L'Enfant Plaza West, S.W.
Room 6536
Washington, D.C. 20260-1137
March 10, 1999

Documents relating to this request should be served upon Mr. Foucheaux
at the above address.

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The United States Postal Service, in accordance with chapter 36 of title 39, United States Code, has determined that the establishment of a new, permanent Business Reply Mail classification, with corresponding fees, would be in the public interest and consistent with the policies and applicable criteria of that title. Accordingly, the Postal Service requests that the Postal Rate Commission submit a recommended decision to the Governors of the Postal Service supporting the implementation of that classification and the corresponding fees.

A principal goal of this Request is to establish a permanent new classification of nonletter-size Business Reply Mail for which the accounting function is performed by application of a weight averaging method, instead of the standard piece-by-piece counting, weighing, and rating method. An equally important objective is to establish applicable Business Reply Mail accounting fees which more closely correspond to the costs of applying this alternative accounting method. A third goal is to improve service for Business Reply Mail recipients whose nonletter-size mail is subject to weight averaging. This more efficient method of rating bulk quantities of nonletter-size BRM creates opportunities for recipients to pick up their mail earlier than if they have to wait for the standard method of piece-by-piece counting, rating, and billing to be applied.

This Request does not encompass any changes to the existing classifications or rates for the classes and subclasses of mail or to the nature of, or fees for, existing special services not specifically addressed herein. The Postal Service does not intend to open up for consideration any classifications, rates or fees, other than those within the scope of its proposal. The Postal Service believes that its proposed classification and fee proposals are consistent with the rates and fees resulting from the last omnibus rate proceeding, Docket No. R97-1. While the Postal Service recognizes that there may be other mail classes or special services for which reforms might be advisable, and is actively considering other reforms, the changes presented in this Request are the only reforms which it is presenting at this time.

The requested amendments to Domestic Mail Classification Schedule § 931 and DMCS Fee Schedule 931, which pertain to Business Reply Mail, will further the general policies of efficient postal operations and reasonable rates and fees enunciated in the Postal Reorganization Act. See 39 U.S.C. §§ 101(a), 403(a), and 403(b). The requested changes also conform to the criteria of 39 U.S.C. §§ 3622(b) and 3623(c).

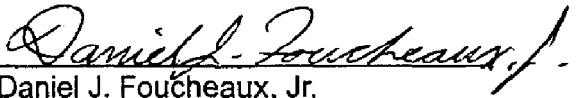
In accordance with the Commission's Rules of Practice and Procedure (particularly, 39 C.F.R. §§ 3001.54 and 3001.64), the Postal Service files with this Request the prepared direct evidence on which it proposes to rely, which consists of four pieces of testimony, including exhibits and workpapers. The page following this Request is an index of Attachments. The testimony, exhibits and workpapers of each witness have been marked for identification as shown in Attachment E. Further data submitted for informational purposes or in response to specific sections of the Rules of Practice are included in the other Attachments.

WHEREFORE, the United States Postal Service, pursuant to 39 U.S.C. §§ 3622(a) and 3623(b), hereby requests that the Postal Rate Commission make and submit a recommended decision to the Governors supporting the proposed revisions to Domestic Mail Classification Schedule § 931 and DMCS Fee Schedule 931, as set forth in Attachments A and B to this Request.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:



Daniel J. Foucheaux, Jr.
Chief Counsel, Rate-making

Michael T. Tidwell

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
March 10, 1999

Docket No. MC99-2 Request

LIST OF ATTACHMENTS

Attachment A	Proposed Changes to Domestic Mail Classification Schedule § 931
Attachment B	Proposed Changes to DMCS Fee Schedule 931
Attachment C	Certification
Attachment D	Audited Financial Statements
Attachment E	Index of Testimony, Exhibits and Workpapers
Attachment F	Compliance Statement

Proposed Changes To Domestic Mail Classification Schedule § 931

In this Request, the Postal Service asks the Commission to recommend the establishment of a permanent classification in the Domestic Mail Classification Schedule (DMCS) for nonletter-size Business Reply Mail which is subject to the weight averaging method of accounting. The current DMCS (which is published in part at 39 C.F.R., Part 3001, Subpart C, Appendix A) is incorporated by reference in this Request. It contains provisions in § 931 which relate either exclusively or jointly to the two experimental accounting methods applicable to nonletter-size Business Reply Mail -- reverse manifesting and weight averaging. See DMCS §§ 931.12, 931.5, 931.51, 931.52, 931.6, 931.61, 931.62, and 931.75. Presently, the final effective date for any DMCS language applying to either of these methods is June 7, 1999. In Docket No. MC99-1, the Postal Service has proposed that the weight averaging experiment be extended and that any pertinent DMCS language be amended to extend the application of that experimental accounting method until February 29, 2000, or until implementation of a permanent classification for weight-averaged nonletter-size BRM, whichever comes first.

The Postal Service hereby proposes DMCS language intended to describe that permanent classification. Any permanent classification for weight-averaged nonletter-size BRM, and thus any DMCS language describing that classification, would not be implemented until the termination of the experiment extension requested in Docket No. MC99-1. At that time, any DMCS language adopted for the purpose of implementing the Docket No. MC99-1 experiment extension would be superseded.

Attachment A (cont'd)

Below, the Postal Service proposes the DMCS changes which are intended to implement the establishment of the permanent classification for weight-averaged nonletter-size BRM proposed in the instant proceeding, Docket No. MC99-2. The Postal Service has indicated what changes would need to be made to the current wording of DMCS § 931. Proposed additions to the appropriate subsections are underlined on the following pages. Proposed deletions are indicated by striking through the portions intended to be eliminated.

In the proposed classification schedule revisions, the Postal Service also has indicated (by striking through them) the provisions which automatically will expire as a result of the expiration of the reverse manifest portion of the current nonletter-size Business Reply Mail experiment on June 7, 1999.

930 PAYMENT ALTERNATIVES

931 BUSINESS REPLY MAIL

931.1 Definitions

931.11 Business reply mail is a service whereby business reply cards, envelopes, cartons and labels may be distributed by or for a business reply distributor for use by mailers for sending First-Class Mail without prepayment of postage to an address chosen by the distributor. A distributor is the holder of a business reply license.

931.12 A business reply mail piece is nonletter-size for purposes of this section if it meets addressing and other preparation requirements, but does not meet the machinability requirements specified by the Postal Service for mechanized or automated letter sortation.

~~This provision expires June 7, 1999.~~

931.2 Description of Service

931.21 The distributor guarantees payment on delivery of postage and fees for all returned business reply mail. Any distributor of business reply cards, envelopes, cartons and labels under any one license for return to several addresses guarantees to pay postage and fees on any returns refused by any such addressee.

931.3 Requirements of the Mailer

931.31 Business reply cards, envelopes, cartons and labels must be preaddressed and bear business reply markings.

931.32 Handwriting, typewriting or handstamping are not acceptable methods of preaddressing or marking business reply cards, envelopes, cartons, or labels.

931.4 Fees

931.41 The fees for business reply mail are set forth in Fee Schedule 931.

931.42 To qualify as an active business reply mail advance deposit trust account, the account must be used solely for business reply mail and contain sufficient postage and fees due for returned business reply mail.

- 931.43 An accounting fee as set forth in Fee Schedule 931 must be paid each year for each advance deposit business reply account at each facility where the mail is to be returned.

931.5 Experimental Reverse Manifest Fees

- ~~931.51 A set-up/qualification fee as set forth in Fee Schedule 931 must be paid by each business reply mail advance deposit trust account holder at each destination postal facility at which it applies to receive nonletter-size business reply mail for which the postage and fees will be accounted for through a reverse manifest method approved by the Postal Service for determining and verifying postage.~~

~~———— A distributor must pay this fee for each business reply mail advance deposit trust account for which participation in the nonletter-size business reply mail experiment is requested.~~

~~———— This provision expires June 7, 1999.~~

- ~~931.52 A nonletter-size reverse manifest monthly fee as set forth in Fee Schedule 931 must be paid each month during which the distributor's reverse manifest account is active.~~

~~———— This fee applies to the (no more than) 10 advance deposit account holders which are selected by the Postal Service to participate in the reverse manifest nonletter-size business reply mail experiment and which utilize reverse manifest accounting methods approved by the Postal Service for determining and verifying postage and fees.~~

~~———— This provision expires June 7, 1999.~~

931.6 Experimental Nonletter-Size Weight Averaging Fees

- ~~931.61 A set-up/qualification fee as set forth in Fee Schedule 931 must be paid by each business reply mail advance deposit trust account holder at each destination postal facility at which it applies to receive nonletter-size business reply mail for which the postage and fees will be accounted for through a weight averaging method approved by the Postal Service for determining and verifying postage.~~

~~———— A distributor must pay this fee for each business reply mail advance deposit trust account for which participation in the nonletter-size business reply mail experiment is requested.~~

~~———— This provision expires June 7, 1999.~~

931.62 A nonletter-size weight averaging monthly fee as set forth in Fee Schedule 931 must be paid each month during which the distributor's weight averaging account is active.

~~———— This fee applies to the (no more than) 10 advance deposit account holders which are selected by the Postal Service to participate in the weight averaging nonletter-size business reply mail experiment.~~

~~———— This provision expires June 7, 1999.~~

931.7 Authorizations and Licenses

931.71 In order to distribute business reply cards, envelopes, cartons or labels, the distributor must obtain a license or licenses from the Postal Service and pay the appropriate fee as set forth in Fee Schedule 931.

931.72 Except as provided in section 931.73, the license to distribute business reply cards, envelopes, cartons, or labels must be obtained at each office from which the mail is offered for delivery.

931.73 If the business reply mail is to be distributed from a central office to be returned to branches or dealers in other cities, one license obtained from the post office where the central office is located may be used to cover all business reply mail.

931.74 The license to mail business reply mail may be canceled for failure to pay business reply postage and fees when due, and for distributing business reply cards or envelopes that do not conform to prescribed form, style or size.

931.75 Authorization to pay ~~experimental~~ nonletter-size weight averaging business reply mail fees as set forth in Fee Schedule 931 may be canceled for failure of a business reply mail advance deposit trust account holder to meet the standards specified by the Postal Service for the ~~applicable reverse manifest or weight averaging~~ accounting method.

~~This provision expires June 7, 1999.~~

Proposed Changes to DMCS Fee Schedule 931

In this Request, the Postal Service asks the Commission to recommend the establishment of permanent fees in the Domestic Mail Classification Schedule (DMCS) for nonletter-size Business Reply Mail which is subject to the weight averaging method of accounting. The current DMCS (which is published in part at 39 C.F.R., Part 3001, Subpart C, Appendix A) is incorporated by reference in this Request. It contains provisions in Fee Schedule 931 which relate either exclusively or jointly to the two experimental accounting methods applicable to nonletter-size Business Reply Mail – reverse manifesting and weight averaging. See DMCS §§ 931.12, 931.6, 931.61, 931.62, and 931.75. Presently, the final effective date for any DMCS language applying to either of these methods is June 7, 1999. In Docket No. MC99-1, the Postal Service has proposed that the weight averaging experiment be extended and that any pertinent DMCS language be amended to extend the application of that experimental accounting method until implementation of a permanent classification for weight-averaged nonletter-size BRM or until the end of February 29, 2000, whichever comes first.

The Postal Service hereby proposes for publication in DMCS Fee Schedule 931 the fees related to its proposed weight-averaged nonletter-size BRM classification. Any permanent fees for weight-averaged nonletter-size BRM would not be implemented until the termination of the experiment extension requested in Docket No. MC99-1. At

Attachment B (cont'd)

that time, any experimental fees adopted for the purpose of implementing the Docket No. MC99-1 experiment extension would be superseded.

Below, the Postal Service proposes the DMCS Fee Schedule 931 changes related to the establishment of the permanent classification for weight-averaged nonletter-size BRM proposed in the instant proceeding, Docket No. MC99-2. Proposed additions to the existing schedule are underlined on the following page. Proposed deletions are indicated by striking through the portions intended to be eliminated.

In the proposed fee schedule revisions, the Postal Service also has indicated (by striking through them) the provisions which automatically will expire as a result of the expiration of the reverse manifest portion of the current nonletter-size Business Reply Mail experiment on June 7, 1999.

FEE SCHEDULE 931

BUSINESS REPLY MAIL

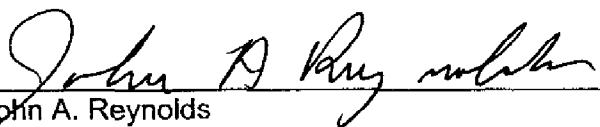
	Fee
Active business reply advance deposit account:	
Per piece	
Qualified	\$0.05
Nonletter-size, using reverse manifest (experimental)	\$0.02
Nonletter-size, using weight averaging (experimental)	\$0.03
Nonletter-size, using weight averaging	\$0.01
Other	\$0.08
Payment of postage due charges if active business reply mail advance deposit account not used:	
Per piece	\$0.30
Annual License and Accounting Fees:	
Accounting Fee for Advance Deposit Account	\$300
Permit fee (with or without Advance Deposit Account)	\$100
Monthly Fees for customers using a reverse manifest or weight averaging for nonletter-size business reply	
Nonletter-size, using reverse manifest (experimental)	\$1,000
Nonletter-size, using weight averaging (experimental)	\$3,000
Nonletter-size, using weight averaging	\$600
Set-up/Qualification fee for customers using a reverse manifest or weight averaging for nonletter-size business reply	
Nonletter-size, using reverse manifest (experimental)	\$1,000
Nonletter-size, using weight averaging (experimental)	\$3,000

~~1-Experimental per piece, monthly, and set-up/qualification fees are applicable only to participants selected by the Postal Service for the nonletter-size business reply mail experiment. The experimental fees expire June 7, 1999.~~

CERTIFICATION

I, John A. Reynolds, Manager, Product Finance, Finance Department, United States Postal Service, am familiar with the attached Request of the United States Postal Service for a Recommended Decision on Classification and Fees for Weight-Averaged Nonletter-Size Business Reply Mail, together with the accompanying direct testimony, exhibits and workpapers.

Pursuant to Rule 54(p) of the Postal Rate Commission's Rules of Practice and Procedure, 39 C.F.R. § 3001.54(p) (1998), I hereby certify that I have read the Request, that the cost statements and supporting data submitted as part of that Request, which purport to reflect the books of the Postal Service, accurately set forth the results shown by such books, and that, to the best of my knowledge, information, and belief, every statement contained in the Request is proper.


John A. Reynolds

March 10, 1999

Audited Financial Statements

Statements of Operations

(dollars in millions)

	Years ended September 30,		
	1998	1997	1996
Operating revenue—Note 8	\$60,072	\$58,216	\$56,402
Operating expenses:			
Compensation and benefits—Notes 2, 6, and 7	45,588	43,835	42,676
Transportation	4,207	4,026	3,736
Other	7,983	7,012	6,701
Total operating expenses	<u>57,778</u>	<u>54,873</u>	<u>53,113</u>
Income from operations	2,294	3,343	3,289
POD workers' compensation expense—Note 3	(8)	(258)	-
Interest and investment income	44	115	142
Interest expense on deferred retirement liabilities—Note 6	(1,597)	(1,597)	(1,449)
Interest expense on borrowings	(167)	(307)	(368)
Imputed interest on OBRA 1993 retroactive assessments for employee benefits—Note 4	<u>(16)</u>	<u>(32)</u>	<u>(47)</u>
Net income	<u>\$ 550</u>	<u>\$ 1,264</u>	<u>\$ 1,567</u>

See accompanying notes to financial statements.

Balance Sheets

(dollars in millions)

	September 30,	
	1998	1997
Assets		
Current assets:		
Cash and cash equivalents	\$ 395	\$ 403
Receivables:		
Foreign countries	514	441
U.S. Government	154	101
Consignment	51	48
Other	154	159
	<u>873</u>	<u>749</u>
Less allowances	88	77
Total receivables, net	785	672
Supplies, advances and prepayments	<u>348</u>	<u>388</u>
Total current assets	1,528	1,463
Other assets, principally revenue forgone appropriations receivable—Note 8	379	372
Property and equipment, at cost:		
Buildings	15,123	13,911
Equipment	11,179	10,328
Land	2,286	2,178
Leasehold improvements	916	797
	<u>29,504</u>	<u>27,214</u>
Less allowances for depreciation and amortization	10,785	9,702
	<u>18,719</u>	<u>17,512</u>
Construction in progress	<u>2,073</u>	<u>1,862</u>
Total property and equipment, net	20,792	19,374
Deferred retirement costs—Note 6	<u>31,844</u>	<u>31,929</u>
Total assets	<u>\$54,543</u>	<u>\$53,138</u>

See accompanying notes to financial statements.

	September 30,	
	1998	1997
Liabilities and Net Capital Deficiency		
Current liabilities:		
Compensation and benefits	\$ 5,290	\$ 5,056
Estimated prepaid postage	1,673	1,743
Payables and accrued expenses:		
Foreign countries	780	703
U.S. Government	148	181
Other	742	940
Total payables and accrued expenses	1,670	1,824
Prepaid box rentals, permit and metered mail	1,955	1,924
Outstanding postal money orders	692	640
Current portion of long-term debt	3,633	2,647
Total current liabilities	14,913	13,834
Long-term debt, less current portion—Note 5	2,788	3,225
Other liabilities:		
Amounts payable for deferred retirement benefits—Note 6	30,138	30,343
Workers' compensation costs—Note 2	4,923	4,749
Employees' accumulated leave	1,959	1,858
Other	632	489
Total other liabilities	37,652	37,439
Commitments and contingencies—Notes 9 and 11		
Total liabilities	55,353	54,498
Net capital deficiency:		
Capital contributions of the U.S. Government	3,034	3,034
Deficit since reorganization	(3,844)	(4,394)
Total net capital deficiency	(810)	(1,360)
Total liabilities and net capital deficiency	\$54,543	\$53,138

See accompanying notes to financial statements.

Statements of Changes in Net Capital Deficiency

(dollars in millions)

	Years ended September 30, 1998, 1997, and 1996		
	Capital Contributions of U.S. Government	Deficit Since Reorganization	Total Net Capital Deficiency
Balance, September 30, 1995	\$3,034	\$ (7,225)	\$ (4,191)
Net Income	<u>-</u>	<u>1,567</u>	<u>1,567</u>
Balance, September 30, 1996	3,034	(5,658)	(2,624)
Net Income	<u>-</u>	<u>1,264</u>	<u>1,264</u>
Balance, September 30, 1997	3,034	(4,394)	(1,360)
Net Income	<u>-</u>	<u>550</u>	<u>550</u>
Balance, September 30, 1998	<u>\$3,034</u>	<u>\$(3,844)</u>	<u>\$ (810)</u>

See accompanying notes to financial statements.

Statements of Cash Flows

(dollars in millions)

	Years ended September 30,		
	1998	1997	1996
Cash flows from operating activities:			
Net income	\$ 550	\$ 1,264	\$ 1,567
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,579	1,673	1,333
Loss on disposals of property and equipment, net	7	19	15
Increase in other assets, principally revenue forgone appropriations receivable	(7)	(18)	(37)
Increase (decrease) in USPS workers' compensation	195	(332)	205
(Decrease) increase in Post Office Department workers' compensation	(27)	258	-
Decrease in retroactive assessments payable to the U.S. Government	(331)	(315)	(300)
Increase in employees' accumulated leave	101	236	67
Increase in other liabilities	143	46	100
Changes in current assets and liabilities:			
(Increase) decrease in receivables, net	(113)	55	151
Decrease (increase) in supplies, advances and prepayments	40	22	(31)
Increase (decrease) in compensation and benefits	451	128	(562)
(Decrease) increase in estimated prepaid postage	(70)	20	26
Decrease in payables and accrued expenses	(154)	(1)	(190)
Increase in prepaid box rentals, permit and metered mail	31	332	162
Increase (decrease) in outstanding postal money orders	52	(40)	(17)
Net cash provided by operating activities	2,447	3,347	2,489
Cash flows from investing activities:			
Purchase of U.S. Government securities, available-for-sale	(620)	(300)	(799)
Proceeds from sale of U.S. Government securities, available-for-sale	622	300	800
Purchase of property and equipment	(3,055)	(3,233)	(2,340)
Proceeds from sale of property and equipment	49	26	4
Net cash used in investing activities	(3,004)	(3,207)	(2,335)
Cash flows from financing activities:			
Issuance of debt	5,696	1,964	1,500
Payments on debt	(5,147)	(2,011)	(2,861)
Net cash provided by (used in) financing activities	549	(47)	(1,361)
Net (decrease) increase in cash and cash equivalents	(8)	93	(1,207)
Cash and cash equivalents at beginning of year	403	310	1,517
Cash and cash equivalents at end of year	\$ 395	\$ 403	\$ 310

See accompanying notes to financial statements.

Notes to the Financial Statements

1. Description of Business

Nature of Operations

The United States Postal Service (Postal Service) provides mail service to the public, offering a variety of classes of mail services without discrimination among its many customers. This means that within each class of mail our price does not vary by customer for the levels of service we provide. This fulfills our legal mandate to offer universal services at a fair price. Our primary lines of business are First-Class Mail, Standard Mail (A) and Priority Mail. The principal markets for these services are the communications, distribution and delivery, advertising and retail markets.

Our products are distributed through our more than 38,000 post offices and a large network of consignees. As in the past, we continue to conduct our significant operations primarily in the domestic market, with our international operations representing less than 3 percent of our total revenue. Our labor force is primarily represented by the American Postal Workers Union, National Association of Letter Carriers, National Postal Mail Handlers Union and National Rural Letter Carriers Association. Almost 90 percent of our career employees are covered by collective bargaining agreements. No agreement expired in fiscal year 1998. However, three of our largest contracts representing 82 percent of our career employees expire November 20, 1998.

Postal Reorganization

The Postal Service commenced operations on July 1, 1971, in accordance with the provisions of the Postal Reorganization Act (the Act). The equity that the U.S. Government held in the former Post Office Department became the initial capital of the Postal Service. The Postal Service valued the assets of the former Post Office Department at original cost less accumulated depreciation. The U.S. Government remained responsible for all the liabilities attributable to operations of the former Post Office Department.

The Balanced Budget Act of 1997 charged the Postal Service with certain liabilities attributable to operations of the former Post Office Department for the first time since postal reorganization. Our

1997 financial statements contained a \$258 million reduction to net income as a result, with an additional \$8 million expense in 1998 (Note 3).

Price Setting Process

Since 1971, the Act has required the Postal Service to establish prices that cover the costs of operating the postal system. The Act established the independent Postal Rate Commission with oversight responsibility for mail prices, subject to approval by the Governors of the Postal Service. The Act provides for the recovery of operating losses through future rate increases.

2. Summary of Significant Accounting Policies

Basis of Accounting and Use of Estimates

The Postal Service maintains its accounting records and prepares its financial statements on the accrual basis of accounting. This basis conforms with generally accepted accounting principles. Following these principles, we made estimates and assumptions that affect the amounts we report in the financial statements and notes. Actual results may differ from our estimates.

Cash Equivalents

Cash equivalents are securities which mature within 90 days or less from the date we buy them.

Current Values of Financial Instruments

We determine the current value of our investments in non-marketable U.S. Government securities based on the current value of equivalent marketable U.S. Government securities. We determine the current value of our debt based on what we estimate it would cost us to pay off the debt if we used the current yield on equivalent U.S. Treasury debt.

Supplies, Advances & Prepayments

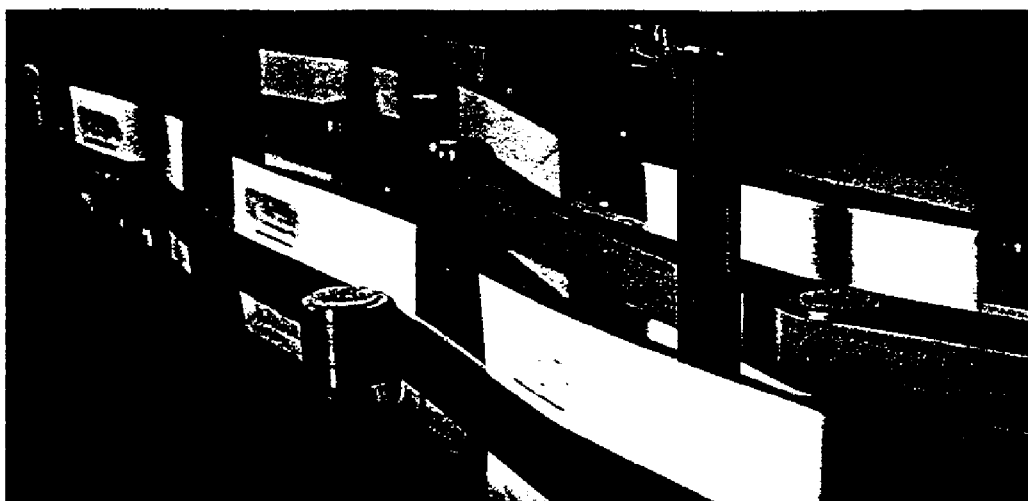
Supplies, advances and prepayments are primarily composed of our inventories of supplies, motor vehicle parts, repairable parts for mail processing equipment and advances to employees for annual leave. We value our inventories at the lower of average cost or current market price. Total inventories amounted to \$158 million at the end of 1998 and \$187 million at the end of 1997.

Property and Equipment

We record property and equipment at what it cost us to acquire the assets, including the interest we

**\$60.1
billion**

Our 1998 total operating revenue was \$60.1 billion.



Our plants use highly efficient equipment to speed your letter on its way.

pay on the money we borrow to pay for the construction of major capital additions. This interest amounted to \$44 million in 1998, \$22 million in 1997 and \$29 million in 1996.

We depreciate buildings and equipment over their estimated useful lives, which range from 3 to 40 years, using the straight-line method. We amortize leasehold improvements over the period of the lease or the useful life of the improvement, whichever time is shorter.

During 1997 we changed our policy for expensing minor asset purchases. We increased the limit from \$2,000 to \$3,000. As a result, we expensed \$83 million of assets in 1997 that were under the new limit.

Estimated Prepaid Postage

This is the amount of cash we estimate that we collected by the end of the year for services that we will perform in the following year.

Compensation and Benefits Payable

This is the salaries and benefits we owe to current and retired employees, including the amounts employees have earned but have not yet been paid, current workers' compensation, unemployment costs, health benefits and the current portion of the amounts payable for retirement benefits.

Deferred Retirement Benefits

This is the present value of our estimated legal obligation to the Civil Service Retirement and Disability Fund for the amount of retirement benefits payable in the future for our current employees' retirement and our present retirees and their survivors. The present value of our benefits payable for our current employees increases

when management increases basic pay. The present value of our benefits payable also increases when Cost of Living Adjustments (COLAs) are granted to our retirees or their survivors. We capitalize as deferred retirement costs the amounts due and payable in future years. We expense and pay these costs over periods of 30 years for amounts attributable to current employees and 15 years for amounts attributable to retirees, at 5 percent interest. We account for our participation in the U.S. Government sponsored retirement plans as participation in a multi-employer plan arrangement.

Post-Retirement Health Benefits

Retiree health benefits costs are our obligation to pay a portion of the health insurance premiums of those retirees and their survivors who participate in the Federal Employees Health Benefits Program (FEHBP). We account for our participation in FEHBP as participation in a multi-employer plan arrangement. Therefore, we expense the costs of our retiree health benefits as we incur them.

Workers' Compensation Costs

We are self-insured for workers' compensation costs under a program administered by the Department of Labor (DOL). We record these costs, which include the employees' medical expenses and payment for continuation of wages, as an operating expense. At the end of the year, our liability represents our estimated present value of the total amounts we expect to pay for outstanding claims. We base our estimate of the total costs of a claim upon the severity of the injury, the age of the injured employee, the assumed life expectancy of the employee, the trend of our experience with such an injury and other factors.

In our calculation of present value, we use a net discount rate of 0.1 percent for medical expenses and 3.0 percent for compensation claims.

In 1996, we changed one of the assumptions we use to estimate our workers' compensation liability. As part of our calculation, we use the trends in our claims for the current year and the claims from previous years to estimate the length of time an employee will receive workers' compensation. Beginning in 1996 we placed greater emphasis on our experience with prior years' claims to estimate this liability. As a result, we had an increase in expense of \$113 million in 1996.

At the end of 1998, we estimate our total liability for future workers' compensation costs at \$5,287 million, excluding Post Office Department (POD) liability (Note 3). At the end of 1997, this liability was \$5,092 million. In 1998, we recorded \$760 million in workers' compensation expense, compared to the \$206 million we recorded in 1997 and the \$737 million we recorded in 1996.

Research and Development Costs

We record research and development costs as expenses when we incur them. These costs were \$77 million in 1998, \$68 million in 1997 and \$56 million in 1996.

Advertising

We record advertising costs as expenses when we incur them. These costs were \$301 million in 1998, \$266 million in 1997 and \$236 million in 1996.

3. Balanced Budget Act of 1997

Under the Postal Reorganization Act of 1971, the U.S. Government remained responsible for payment of all Post Office Department (POD) workers' compensation claims incurred before June 30, 1971. This Act required that the newly-created USPS would be responsible only for its own workers' compensation claims. However, under the Balanced Budget Act of 1997, the remaining liability for these POD costs has now been transferred to the U.S. Postal Service. We estimate the present value of these claims was \$258 million at the end of 1997. We recorded this amount as an expense for 1997. The 1998 expense is \$8 million, and the estimated liability is \$231 million. In our calculation we use a net discount rate of 3 percent.

4. Retroactive Assessments for Employee Benefits

Omnibus Budget Reconciliation Act of 1993

Under the Omnibus Budget Reconciliation Act of 1993, we must pay 5 percent interest on the \$2.14 billion retroactive assessment from the Omnibus Budget Reconciliation Act of 1990. We paid this interest in three equal annual installments totaling \$1.041 billion. We made the first payment in 1996 and the second in 1997 for a total of \$694 million. We made the final payment this year of \$347 million.

5. Debt and Related Interest Costs

Under the Postal Reorganization Act, as amended by Public Law 101-227, we can issue debt obligations. However, we are limited to net annual increases of \$2 billion in our debt for capital improvements and to \$1 billion for operating expenses. Our total debt cannot exceed \$15 billion.

Debt is due as follows (dollars in millions):

Year	Amount
1999	\$3,633
2000	84
2001	52
2002	201
2003	-
After 2003	2,451

We paid in cash \$236 million in interest in 1998, \$336 million in interest in 1997 and \$473 million in 1996.

The current estimated market value of our debt is \$6,639 million in 1998 and \$6,102 million in 1997 (Note 2). All notes payable to the Federal Financing Bank (FFB) may be repurchased at current value at any time with five days notice of intent to do so.

The following page details our debt, which consists of notes payable to the FFB and mortgage notes payable:

**\$3.1
billion**

We spent \$3.1 billion in 1998 on capital improvements to serve our customers better.

OUR DEBT CONSISTS OF THE FOLLOWING

(dollars in millions)

Interest Rate %	Terms	September 30,	
		1998	1997
Notes Payable to the Federal Financing Bank (FFB):			
8.075	Payable \$32 million each year to May 31, 2000	\$ 64	\$ 96
7.800	Payable \$15 million each year to May 31, 2001	45	60
7.591	Payable \$50 million each year to June 1, 1997 and \$23 million due on June 1, 1998	-	23
8.474	Payable \$30 million each year to June 1, 1998	-	30
8.908	Payable \$35 million each year to June 1, 1998	-	35
9.074	Payable \$60 million each year to June 1, 1998	-	60
8.761 "	Payable \$24 million on June 2, 1997; payments of \$36 million each year on June 1, 1998-1999; and payments of \$36 million each year thereafter through May 31, 2001	108	144
7.786	Payable September 30, 1998	-	450
7.367	Payable August 15, 2002	-	1,500
7.615	Payable November 30, 2007	-	1,000
6.274	Payable May 16, 2005	500	500
4.491 **	Overnight revolving credit facility; final maturity date November 30, 1998	246	164
4.667	Payable November 15, 2026; repurchasable at par November 16, 1998 and every February 15, May 15, and August 15 thereafter	600	-
4.667 ***	Short-term revolving credit facility; final maturity date November 30, 1998	2,700	1,800
5.568	Payable December 31, 2002	200	-
5.688	Payable August 15, 2007	400	-
5.546	Payable August 15, 2007	150	-
5.959	Payable November 15, 2027	400	-
5.726	Payable November 15, 2027	100	-
5.606	Payable November 15, 2027	300	-
5.426	Payable May 15, 2008	200	-
4.981	Payable May 15, 2008	200	-
4.910	Payable May 15, 2008	200	-
		<u>6,413</u>	<u>5,862</u>
Mortgage Notes Payable:			
5.00 to 9.75	Maturing from fiscal years 1999 through 2039 secured by land, buildings and equipment with a carrying amount of \$41 million. (Aggregate annual installments approximate \$1 million.)	8	10
		<u>6,421</u>	<u>5,872</u>
Less current portion of debt		<u>3,633</u>	<u>2,647</u>
		<u>\$2,788</u>	<u>\$3,225</u>

* Weighted average interest rate; prior year's weighted average interest rate was 8.764%.

** Prior year rate was 5.312%.

*** Prior year rate was 5.198%.

6. Retirement Programs

With certain exceptions, employees participate in one of the following three retirement programs based upon the starting date of their employment with the Postal Service. Employee and employer contributions are made to the Civil Service Retirement and Disability Fund (CSRDF), which is administered by the Office of Personnel Management. Employees may also participate in the Thrift Savings Plan, which is a defined contribution retirement savings and investment plan. Postal Service employees are authorized to participate in the Thrift Savings Plan by the Federal Employees Retirement System Act of 1986. The Plan is administered by the Federal Retirement Thrift Investment Board.

Civil Service Retirement System (CSRS)

Under the Postal Reorganization Act, officers and career employees are covered by the Civil Service Retirement System, which provides a basic annuity and Medicare coverage. The CSRS fund covers substantially all employees hired prior to January 1, 1984. We and the participating employee each contribute 7 percent of the employee's basic pay to the CSRDF. We and the employee also contribute to Medicare at the rate prescribed by law. We do not match contributions to the Thrift Savings Plan for employees who participate in the CSRS.

Dual Civil Service Retirement System (Dual CSRS)/Social Security System

Employees with prior U.S. Government service who were hired between January 1, 1984 and January 1, 1987 are covered by the Dual Civil Service Retirement System/Social Security System. We contribute 7 percent of the employee's basic pay to the CSRDF. The employee contributes 0.8 percent of basic pay. We and the employee also contribute to Social Security and Medicare at the rates prescribed by law. We do not match contributions to the Thrift Savings Plan for employees who participate in the Dual System.

Federal Employees Retirement System (FERS)

Effective January 1, 1987, officers and career employees hired since December 31, 1983, except for those covered by the Dual System, are covered by the Federal Employees Retirement System Act of 1986. In addition, employees hired before January 1, 1984 could choose during certain periods in 1987 and 1988 to participate in the

FERS. This System consists of Social Security, a basic annuity plan, and a Thrift Savings Plan.

We contributed to the basic annuity plan 10.7 percent of each employee's basic pay in 1998 and 11.4 percent in 1997 and 1996. Employees contributed 0.8 percent of their basic pay in these years. We and the employee also contribute to Social Security and Medicare at the rates prescribed by law. In addition, we are required to contribute to the Thrift Savings Plan a minimum of 1 percent per year of the basic pay of employees covered by this System. We also match a voluntary employee contribution up to 3 percent of the employee's basic pay, and 50 percent of a contribution between 3 percent and 5 percent of basic pay.

The number of employees enrolled in each of the retirement plans at the end of 1998, 1997 and 1996 is as follows:

	1998	1997	1996
CSRS	298,827	314,068	328,270
Dual CSRS/ Social Security	13,418	13,900	14,320
FERS	479,069	436,735	417,948

Deferred Retirement Costs

Deferred retirement costs consist of the following deferred liabilities (dollars in millions):

	1998	1997
CSRS basic pay increases	\$25,827	\$26,133
CSRS retirees' and survivors' cost of living adjustments	6,017	5,796
Total	<u>\$31,844</u>	<u>\$31,929</u>

There are no deferred retirement costs associated with FERS.

Deferred Retirement Liability—Civil Service Retirement System

When we increase our employees' current basic pay, we are liable for the additional deferred retirement liability. The liability results from the increase in our employees' retirement benefits which are based on this pay increase. The Office of Personnel Management determines the estimated increase in our deferred liability. We amortize and pay this amount in 30 equal annual installments, which includes interest computed at a rate of 5 percent per year. We make the first payment at the end of the year in which employees receive their pay increase.

The increase in our deferred liability for retirement benefits under the CSRS as a result of basic pay increases was \$836 million in 1998, \$560 million in 1997 and \$3,696 million in 1996.

Deferred Retirement Liability— Retirees' and their Survivors' Cost of Living Adjustments (COLAs)

Congress determines the COLAs granted to our retirees. Under the Omnibus Budget Reconciliation Act of 1990, we are liable for our share of the cost of living adjustments granted to those retirees, and their survivors, retiring on or after July 1, 1971. We are not responsible for any costs due to Federal civilian service before that date.

Each year the Office of Personnel Management determines the estimated increase in our liability under this law for the current year. We amortize and pay each year's amount in 15 equal annual installments, which include interest computed at a rate of 5 percent per year.

The increase in our deferred liability for our retirees' COLAs was \$790 million in 1998, \$1,041 million in 1997 and \$951 million in 1996.

Future Minimum Payments

We estimate the future minimum payments we have to make in order to fund CSRS benefits and retirees' cost of living adjustments as of September 30, 1998, are as follows (dollars in millions):

Year	Amount
1999	\$ 3,301
2000	3,282
2001	3,274
2002	3,203
2003	3,124
After 2003	<u>32,507</u>
	\$48,691
Less amount representing interest	<u>16,834</u>
Total future minimum payments	\$31,857
Less: Portion classified as a current liability in compensation and benefits	<u>1,719</u>
Long-term portion of future minimum payments	<u>\$30,138</u>

Expense Components

Listed below are the components of our total retirement expenses that are included in our compensation and benefits expense and related interest expense in the Statement of Operations for 1998, 1997 and 1996 (dollars in millions):

	1998	1997	1996
CSRS	\$ 849	\$ 870	\$ 877
FERS	<u>1,640</u>	<u>1,590</u>	<u>1,473</u>
FERS—Thrift Savings Plan	608	552	489
Dual CSRS/Social Security	36	36	36
Social Security	<u>1,241</u>	<u>1,162</u>	<u>1,082</u>
Amortization of deferred cost:			
CSRS	1,142	1,064	1,157
Annuitant COLAs	<u>569</u>	<u>552</u>	<u>507</u>
Interest expense on deferred liabilities	<u>1,597</u>	<u>1,597</u>	<u>1,449</u>
Imputed interest on OBRA '93	<u>16</u>	<u>32</u>	<u>47</u>
Total retirement expense	<u>\$7,698</u>	<u>\$7,455</u>	<u>\$7,117</u>

7. Post-Retirement Health Benefit Programs

Employees of the Postal Service who participate in the Federal Employees Health Benefits Program (FEHBP) for at least the five years immediately before their retirement may participate in the FEHBP during their retirement. Under the FEHBP, we pay a portion of the health insurance premiums of participating retirees and their survivors. This Program is administered by the Office of Personnel Management.

The Omnibus Budget Reconciliation Act of 1990 requires us to pay the employer's share of health insurance premiums for all employees, and their survivors, who participate in the FEHBP and who retire on or after July 1, 1971. However, we do not include the costs attributable to Federal civilian service before that date. Our FEHBP costs amounted to \$581 million in 1998, \$548 million in 1997 and \$497 million in 1996. We include these costs in our compensation and benefits expense.

8. Revenue Forgone

Our operating revenue includes accruals for revenue forgone. Revenue is forgone when Congress mandates that we provide free or reduced mail rates for certain mailers. The difference between the price Congress has mandated and the price we would have charged the mailer determines the amount of forgone revenue. Congress appropriates money to reimburse us for only a portion of the revenue forgone that we have incurred in past years. In our operating revenue, we have included as revenue the amounts for revenue forgone of \$67 million for 1998, \$83 million for 1997 and \$93 million for 1996. Legislation that was passed after our year ended appropriated \$71 million for 1999 but delayed the payment until fiscal year 2000. Accordingly, we will record this as a receivable in 1999.

**\$1.6
billion**

We typically pay
\$1.6 billion in salary
and benefits every
two weeks.

Under the Revenue Forgone Reform Act of 1993, Congress is required to reimburse us \$29 million annually through 2035 (42 years). This reimbursement is for two purposes: services we performed in 1991, 1992 and 1993 for which we have not yet been paid; and for shortfalls in the reimbursement for the costs we incurred for processing and delivering certain nonprofit mail from 1994 through 1998. Legislation passed after our year end failed to appropriate the \$29 million owed for FY 1999. We can only assume, based on subcommittee notes, that they do intend to pay us this amount but that the payment is delayed. Because of the uncertainty of the legislative intent we have recorded an allowance for the principal portion of this installment in our bad debt account. If Congress doesn't pay us, we can by law make up that lost income by adjusting our rates on all mailers through the postal rate making process.

The Revenue Forgone Reform Act of 1993 authorized a total of \$1.218 billion in payments. We calculate the present value of these future reimbursements to be approximately \$390 million at 7 percent interest. At the end of 1998, we have recognized cumulative revenues of approximately \$390 million. The amounts receivable as of September 30, 1998 and 1997 were \$380 million and \$372 million, respectively. We recognized revenue of \$10 million in 1998, \$22 million in 1997 and \$37 million in 1996.

9. Commitments

At September 30, 1998, we estimate our financial commitment for approved Postal Service capital projects in progress is \$3.7 billion.

Our total rental expense for the years ended September 30 is summarized as follows (dollars in millions):

	1998	1997	1996
Noncancellable real estate leases including related taxes	\$711	\$659	\$616
Facilities leased from General Services Administration subject to 120-day notice of cancellation	37	34	36
Equipment and other short-term rentals	234	154	153
Total	\$982	\$847	\$805

At September 30, 1998, our future minimum lease payments for all noncancellable leases are as follows (dollars in millions):

Year	Operating	Capital
1999	\$ 681	\$ 54
2000	637	54
2001	577	54
2002	524	54
2003	479	54
After 2003	4,772	255
	\$7,670	525
Less: Interest at 6.5 percent		137
Total capital lease obligations		388
Less: Short-term portion of capital lease obligations		30
Long-term portion of capital lease obligations		\$358

Most of these leases contain renewal options for periods ranging from 3 to 20 years. Certain noncancellable real estate leases give us the option to purchase the facilities at prices specified in the leases.

Capital leases included in buildings were \$388 million in 1998 and \$272 million in 1997. Total accumulated amortization is \$86 million in 1998 and \$54 million in 1997. Amortization expense for assets recorded under capital leases is included in depreciation expense.

10. Impaired Assets

In 1997, we began to record losses on long lived assets when events and circumstances indicate that the assets might be impaired. In accordance with FASB Statement No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to Be Disposed Of," we have written down our impaired assets to the lower of cost or fair value. We have identified several properties that qualify due to either obsolescence or earthquake damage. The loss reported in 1997 for these impaired assets is \$57 million which has been included in other operating expense in the 1997 Statement of Operations. No material impairments were recorded in 1998.

11. Contingent Liabilities

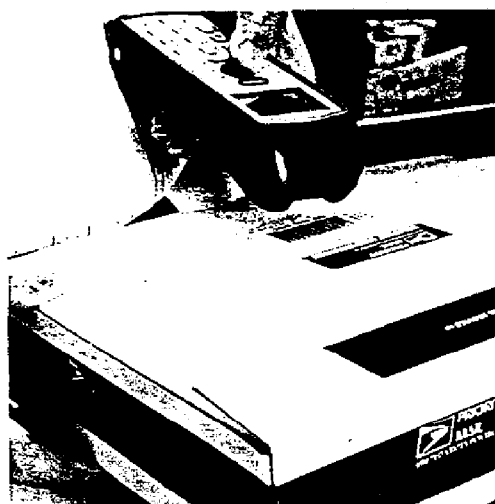
Each quarter we review litigation pending against us. As a result of this review, we classify and adjust our contingencies for claims which we think it is probable that we will lose and for which we can reasonably estimate the amount of the unfavorable outcome. These claims cover labor, equal employment opportunity, environmental issues, traffic accidents, injuries on postal properties, personal claims and property damages, and suits and claims arising from postal contracts. We also recognize the settlement of claims and lawsuits and revisions of other estimates.

As a part of our continuing evaluation of estimates required in the preparation of our financial statements, we recorded approximately \$21 million decrease in liabilities in 1998, \$26 million decrease in liabilities in 1997 and increased liabilities by approximately \$120 million in 1996. We recognized settlement of claims and lawsuits and revised other estimates in our changes in contingent liabilities. Management and General Counsel believe that we have made adequate provision for the amounts which may become due under the suits, claims and proceedings we have discussed here.

12. Year 2000 Disclosure (Unaudited)

Consequences of failure to resolve the Year 2000 problem may range from minor effects on administrative or financial systems to having some impact on the ability of the Postal Service to sort and deliver mail. As part of our overall plan to address the Year 2000 Issue, we have completed assessments of our computer applications and mail processing systems to identify risk areas where these systems may have errors or failures beyond year 1999. Our assessments identified systems that required remediation, especially those that are critical to the operation of the USPS. So far, we have spent \$94 million in upgrading our systems and preparing for year 2000 readiness, and the total cost is expected to approach \$500-600 million.

As of September 15, 1998, remediation efforts prior to testing had been completed on approximately 69 percent of all critical systems, including 93 percent of financial systems. We expect to complete the remaining remediation work, testing and implementation by the end of June 1999. Testing at a major mail processing plant and a bulk mail center revealed that the mail processing equipment can correctly process letters, flats and parcels to and through the Year 2000. To further prepare for the Year 2000 transition, we are developing contingency plans to address business continuity of our most critical systems and business processes, failures in the readiness of key suppliers and other third parties in order to minimize the impact on the USPS and our ability to deliver the mail.



In order to add value to our expedited delivery services, we will soon be able to confirm that delivery has been made.

Audit Committee Chairman's Letter

The members of the Audit Committee are selected by the Chairman of the Board of Governors. During 1998, the Committee, consisting of myself, Governors Ballard and McWherter, met seven times in conjunction with the regularly scheduled monthly Board meetings.

The Audit Committee is responsible, on behalf of the Board of Governors, for reviewing the financial reporting process, ensuring the soundness of the accounting and control practices, and the integrity of the financial statements of the Postal Service. As a part of that responsibility, the Committee also reviews other related issues as appropriate.

The Committee also recommends to the Board of Governors, subject to its approval, the selection of the independent public accounting firm responsible for the external audit work and oversees compliance with the terms of the contract.

During 1998, the Committee recommended and the Board approved changes to the Board's Audit Charter which were necessary to recognize the shift in audit responsibilities from the Inspection Service to the Office of the Inspector General.

The Committee discussed the overall scope of the work and the specific audit plans with the external auditors, Ernst & Young LLP, the Office of the Inspector General and the Postal Inspection Service at the start of the audit process. We also met regularly with management, the Inspector General, the Inspection Service, Ernst & Young, and the General Counsel jointly and, as appropriate, independently to discuss the progress of the audit work. This included an evaluation of the organization's internal controls and the quality of the financial reporting process. This also provided the opportunity for the Committee to assess the coordination of the audit work and ensure the independence and objectivity of the internal and external audit programs.

Accordingly, the Committee recommended and the full Board approved the financial statements for 1998.



Einar V. Dyhrkopp
Chairman, Audit Committee
December 8, 1998

Report of Independent Auditors

Board of Governors
United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 1998 and 1997, and the related statements of operations, changes in net capital deficiency and cash flows for each of the three years in the period ended September 30, 1998. These financial statements are the responsibility of the United States Postal Service's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards for financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the United States Postal Service at September 30, 1998 and 1997, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 1998, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 10, 1998, on our consideration of the United States Postal Service's internal control over financial reporting and on tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Ernst + Young LLP

Washington, D.C.
November 10, 1998

Index of Testimony, Exhibits and Workpapers

INDEX OF TESTIMONIES/DOCKET NO. MC99-2

WITNESS	TESTIMONY	EXHIBITS		ATTORNEY
		TITLE	NUMBER	
Ms. Shields	USPS-T-1			Michael Tidwell (202) 268-2998
Mr. Ellard	USPS-T-2	Materials for Non-CBCIS Facilities	USPS-2A	"
		Screening Questionnaires	USPS-2B	
		Information Packet	USPS-2C	
		Follow-Up Materials	USPS-2D	
Ms. Schenk	USPS-T-3	Schedule for Sampling at Sites	USPS-3A	"
		Cost Survey Instructions and Forms	USPS-3B	
Mr. Kiefer	USPS-T-4	Revenue and Cost Impacts	USPS-4A	"

ATTACHMENT E

			WORKPAPERS	
Ms. Schenk	USPS-T-3	Schenk Workpaper I (filed subject to Motion for Protective Conditions)		

COMPLIANCE STATEMENT

This Attachment contains a statement of the manner in which the Postal Service has supplied the information requested in sections 54 and 64 of the Commission's Rules of Practice and Procedure (39 CFR §§ 3001.54 and 3001.64). Where requested information is not included in direct testimony or exhibits of the Postal Service's witnesses, it is contained in the Request or in this or other attachments to the Request, or has been incorporated by reference in the testimony, exhibits, Request, or attachments, and made available to the Commission, or is subject to a motion for waiver of certain provisions of the Commission's Rules.

RULE:54(b)(1), (2), (3), (4)

INFORMATION REQUESTED: These rules request the submission of schedules of the existing effective rates of postage and fees for all postal services and those rates and fees as proposed to be changed or adjusted. The schedules must:

- (1) show the full rates and, where applicable, the phased rates under section 3626 of title 39, U.S.C., and any proposed adjustment to such phased rates under section 3627 of title 39, U.S.C., indicated by the circumstances known at the time of the filing;
- (2) be presented in a summary fashion and a tariff-like form, specifying those rules, regulations and practices which establish the conditions of mailability and the standards of service. Specifically, they must address such functions as mail pickup and delivery, processing and other similar functions;
- (3) contain a statement of the degree of economic substitutability between the various classes and subclasses; and
- (4) be accompanied by an identification of all nonpostal services.

1. Present and Proposed Rates, Fee and Classification Schedule Provisions.

Attachment A to this Request includes the proposed changes to Domestic Mail Classification Schedule § 931 for weight-averaged nonletter-size Business Reply Mail.

Attachment B incorporates sets forth the proposed changes to DMCS Fee Schedule 931 for weight averaged nonletter-size BRM.

2. Rules, Regulations, and Practices that Establish Conditions of Mailability and Standards of Service.

The rules, regulations, and practices that establish conditions of mailability and standards of service are published in the Domestic Mail Manual and are incorporated by reference in 39 C.F.R. § 111.1. The Postal Service's response to Rule 54(b)(2) should not be construed to admit that the Commission's jurisdiction extends to any of the specified rules, regulations, or practices.

3. Degree of Economic Substitutability and Identification of Nonpostal Services.

The proposed implementation of a permanent classification and fees for weight-averaged nonletter-size Business Reply Mail is not expected to cause substitution among mail classes or rate categories, but is expected to have an impact on the volume of Other nonletter-size BRM not subject to weight averaging. See the testimony of Dr. Kiefer (USPS-T-4).

Information responsive to this rule regarding the degree of economic substitutability among mail classes and services was provided in Docket No. R97-1 and is reflected in the Opinion of the Commission in that proceeding. To the extent that further information is required under this Rule, the Postal Service requests that the requirement be waived.

4. Nonpostal services include: alien registration, sale of philatelic products, sale of food stamps, sale of passports, sale of migratory bird hunting and

conservation stamps, sale of miscellaneous products, Mailgram,¹ photocopy service, vending stands and vending machines, postmasters in Alaska as notaries public, and post office assistance to the Office of Personnel Management and the Selective Service System. From time to time, the Postal Service may offer other nonpostal services. Some of these nonpostal services may be provided on a limited or trial basis.

¹ Although not a service, Mailgram is included here in recognition of its nonpostal nature.

RULE:54(c)

INFORMATION REQUESTED:

This rule requires "an identification of the characteristics of the mailer and recipient, and a description of the contents of items mailed within the various classes and subclasses of mail and service."

Information responsive to this rule was provided by the Postal Service in Docket No. R97-1 and is reflected in the Opinion of the Commission in that proceeding.

With respect to Business Reply Mail, such information may be found in the Docket No. MC99-2 testimony of Dr. Kiefer (USPS-T-4).

RULE: 54(d)

INFORMATION REQUESTED:

This rule requests "an identification of the physical attributes of the items mailed by class and subclass, including shape, weight, and distance."

With respect to Business Reply Mail, such information may be found in the testimony of Dr. Kiefer (USPS-T-4). A motion seeking a waiver of this rule, insofar as it requires information about distance, has been filed.

RULE:54(e)

INFORMATION REQUESTED:

To the extent such information is not included within material supplied under rule 54(b)(2), this rule requests "a summary statement describing special service arrangements provided to, or requested or required of, mailers by the Postal Service which bear upon the cost of service or the value of the mail service to both the sender and the recipient, e.g., services relating to mailer preparations in excess of requirements specified by the [Domestic Mail Manual], pick-up and delivery, expedited or deferred processing, and other similar activities performed."

The requirements for weight-averaged nonletter-size Business Reply Mail are described in the testimony of witness Kiefer (USPS-T-4), and in the DMM referenced in response to Rule 54(b)(2).

RULE:54(f)(1)

INFORMATION REQUESTED:

This rule requests the submission of "the total actual accrued costs during the most recent fiscal year for which they are reasonably available."

Actual accrued costs for FY 1997 are presented in the Cost & Revenue Analysis (CRA) Report, which was filed with the Commission in accordance with 39 C.F.R. § 102 on June 2, 1998.

RULE:54(f)(2) (Basic Submissions)

INFORMATION REQUESTED:

This rule requests:

- for the year in which the filing is made, estimates of the total actual accrued costs of the Postal Service, assuming the prefiling (existing) rates and fees;
- for the year in which the filing is made, estimates of the total actual accrued costs of the Postal Service, assuming the proposed rates and fees;
- for a year which forms the basis for the proposed rates and fees, beginning not more than 24 months after the filing date of the Request, estimates of the total actual accrued costs of the Postal Service, assuming the prefiling (existing) rates and fees;
- for a year which forms the basis for the proposed rates and fees, estimates of the total actual accrued costs of the Postal Service, assuming the proposed rates and fees.

The Postal Service requests that the requirement be waived, insofar as it requires more information than is provided in the testimonies of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4) concerning Business Reply Mail.

RULE:54(f)(2) (Methods and Procedures)

INFORMATION REQUESTED:

For the estimated total accrued costs specified in this provision, the rule requests an explanation of the methods and procedures used for the cost projections, including

- an explanation of the projection of total volumes;
- an explanation of the effect of the projected volume levels on estimated total costs;
- specification of the cost savings which will be realized from gains and improvements in total productivity, indicating such factors as operational and technological advances and innovations;
- identification of abnormal costs which are expected to be incurred in the test year.

The Postal Service requests that the requirement be waived, insofar as it requires more information than is presented in the testimonies of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4).

RULE:54(f)(3)(i) and (ii) (Operating Costs)

INFORMATION REQUESTED:

This rule requires that the cost presentations prepared in response to paragraphs (f)(1) and (f)(2) of Rule 54 must show the following:

- the Postal Service's operating costs, described in "sufficient detail as to the accounting and functional classifications and with such reasonable explanation so that the actual or estimated amount for each item of expense may be readily understood"; and
- full explanations for the amounts included for depreciation on capital facilities and equipment, debt service, contingencies, and extraordinary or nonrecurring expenses.

The testimonies of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4) provide information responsive to this subsection with respect to weight-averaged nonletter-size Business Reply Mail. With respect to the effects on changes in depreciation costs, however, a motion to waive this requirement of the rule, insofar as it applies to weight-averaged nonletter-size Mail, has been filed with the Request. Because of the very limited nature of the classification and fee proposal, the Postal Service has not prepared a full analysis of its effects on operating and depreciation costs, either in the present year or a "rollforward" analysis in a future test year.

RULE:54(f)(3)(iii) (Cost Assignment and Distribution)

INFORMATION REQUESTED:

This rule requires that the cost presentations prepared in response to paragraphs (f)(1) and (f)(2) of Rule 54 must show the assignment and distribution of costs to each of the functions "comprising the mail process," including,

- an itemization of costs by the major accounts as reflected by the Service's books of account for all cost segments;
- an itemization of costs by functions such as collection, acceptance, general overheads, etc.;
- an assignment and distribution of the costs by account, together with related mail volumes, for each function;
- an assignment and distribution of the costs by account, together with related mail volumes, to "such subfunctions within each category for which information is available or can be developed";
- an explanation of the method by which the costs by account are assigned and distributed to functions.

The testimonies of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4) provide information responsive to this subsection with respect to weight-averaged nonletter-size Business Reply Mail. With respect to the effects on changes in functional costs, however, a motion to waive this requirement of the rule, insofar as it applies to weight-averaged nonletter-size Mail, has been filed with the Request. Because of the very limited nature of the classification and fee proposal, the Postal Service has not prepared a full analysis of its effects on functional costs, either in the present year or a "rollforward" analysis in a future test year.

RULE:54(g)

INFORMATION REQUESTED:

This rule requests historical costs for "each fiscal year since the last filing pursuant to this section" to be submitted "in a form as nearly consistent as possible with the filing under [rule 54(f)], together with explanations of any departures from such form and the effect of such departures."

Actual accrued costs for FY 1997 are presented in the Cost & Revenue Analysis (CRA) Report on file with the Commission.

RULE:54(h)(1)

INFORMATION REQUESTED:

This rule requests the separation of actual and estimated total costs, for the fiscal years specified in Rule 54(f), as between postal services (including international mail) and nonpostal services. "The presentation shall show the methodology for separating postal costs as between postal services and nonpostal services, and shall be in sufficient detail to allow a determination that no nonpostal costs have been assigned or allocated to postal services."

The testimonies of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4) provide information responsive to this subsection with respect to weight-averaged nonletter-size Business Reply Mail. To the extent that further information is required under this Rule, the Postal Service requests that the requirement be waived.

RULE:54(h)(2) and (3) (Separation of costs)

INFORMATION REQUESTED:

For the actual and estimated total costs presented for the years specified in rule 54(f), these rules request the costs to be separated as follows:

- those direct costs which can be attributed to each class of mail or type of mail service;
- those indirect costs which can be attributed to each class of mail or type of mail service;
- any other costs of the Service which can be reasonably assigned to each class of mail or type of mail service;
- any other costs of the Postal Service which cannot be attributed or reasonably assigned.

The methodology used to derive these costs is requested to be set forth in detail.

The testimonies of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4) provide information responsive to this subsection with respect to weight-averaged nonletter-size Business Reply Mail. To the extent that further information is required under this Rule, the Postal Service requests that the requirement be waived.

RULE:54(h)(4), (12)

INFORMATION REQUESTED:

This rule applies to the costs identified in rule 54(h)(2). It requests that these costs be separately attributed to mail classes, subclasses, and special services. It also requests identification of the methodology used in attribution and an analysis of the effect of costs on the following:

- volume;
- peaking patterns;
- priority of handling;
- mailer preparations;
- quality of service;
- the physical nature of the item mailed;
- expected gains in total productivity, indicating such factors as operational and technological advances and innovations;
- any other factor affecting costs.

The data relevant to the analyses of the effect on costs of these factors is also to be provided.

The testimonies of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4) provide information responsive to this subsection with respect to weight-averaged nonletter-size Business Reply Mail. To the extent that further information is required under this Rule, the Postal Service requests that the requirement be waived.

RULE:54(h)(5) - (h)(10) ("Roll-Forward" model)

INFORMATION REQUESTED:

These provisions generally specify particular items which are to be included in the presentation of the process by which base year costs are rolled-forward to test-year costs, such as listings of the forecasting factors, piggyback factors, interim period workpapers, and an overall summary cost table. Rules 54(h)(6) and (7) request an explanation of the attributable cost final adjustments and the "other services" adjustments.

The testimonies of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4) provide information responsive to this subsection with respect to weight-averaged nonletter-size Business Reply Mail. To the extent that further information is required under this Rule, the Postal Service requests that the requirement be waived.

RULE:54(h)(11) (Nonattributed costs)**REQUIREMENT:**

This rule applies to costs that are identified as "nonattributed or unassigned" pursuant to rule 54(h)(2). It requests an explanation as to why such costs cannot be attributed or assigned. It further requests the identification, to the extent possible, of all such costs which benefit more than one class of mail or type of service (but not all classes or types), together with the mail classes or types of services so benefitted.

Nonattributed costs are identified as institutional, or residual costs. These costs are not attributed because they do not vary in response to small changes in volumes of any particular class or subclass of mail or type of service, and are not the fixed costs of providing a specific class, subclass, or type of service. The testimonies of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4) provide information responsive to this subsection with respect to weight-averaged nonletter-size Business Reply Mail. To the extent that further information is required under this Rule, the Postal Service requests that the requirement be waived.

RULE:54(i)

REQUIREMENT:

This rule requires a statement of the criteria employed by the Postal Service in construction of the proposed rate schedule. The statement is to include:

- - the identification of the relationship between the revenues derived from the rates and fees for a particular class and subclass of mail or service and the costs attributed and assigned to that class or subclass of service;
 - the identification of the procedures and methods used to apportion (to postal services) that part of the total revenue requirement, which is in excess of costs attributed;
 - such other studies, information and data relevant to the criteria established by section 3622 of title 39, U.S.C., with appropriate explanations as will assist the Commission in determining whether or not the proposed rates or fees are in accordance with such criteria.

The testimonies, exhibits and workpapers of witnesses Schenk (USPS-T-3) and Kiefer (USPS-T-4) respond to this Rule. To the extent that further information is required under this rule, the Postal Service requests that the requirement be waived.

RULE:54(j)(1), (2), (3), and (4)

INFORMATION REQUESTED:

These rules request specification of revenues for certain fiscal years, including the test year. Revenues are to be submitted for

- test year, assuming prefiling (existing) rates and fees;
- test year, assuming proposed rates and fees.

The actual and estimated revenues for these years are to be shown in total and separately for each class and subclass of mail and postal service and for all other sources from which the Postal Service collects revenues.

Each revenue presentation is to be supported by identification of the methods and procedures employed.

The Postal Service requests that the requirement be waived, to the extent that responsive information is not provided in the testimony of Dr. Kiefer (USPS-T-4).

RULE:54(j)(5) (volume estimates)

REQUIREMENT:

This rule requires that the Postal Service present for each class and subclass of mail and special service

- for each postal quarter beginning with the first quarter of the most recent complete fiscal year and ending one year beyond the last quarter of the test year, actual or estimated mail volumes at the prefiled (existing) rates and fees;
- for each postal quarter beginning with the quarter in which the rates are assumed to become effective and ending one year beyond the last quarter of the test year, the estimated volume of mail assuming the effectiveness of the proposed rates.

The Postal Service requests that the requirement be waived, to the extent that it compels the development of a volume estimate beyond that provided by witness Ellard (USPS-T-2).

RULE: 54(j)(5), (6), (7) (Demand study – methodology and documentation)

REQUIREMENT:

These rules require that the volume estimates provided pursuant to Rule 54(j)(5) must be derived from an econometric demand study relating postal volumes to their economic and noneconomic determinants, including postal rates, discounts and fees, personal income, business conditions, competitive and complementary postal services, competitive and complementary nonpostal activities, population, trend, seasonal patterns and other factors. The study must be furnished with the request, and any departure from the assumptions and specifications in the demand study made in estimating volumes of any class or subclass of mail must be explained. If different billing determinants are used for volume forecasting and revenue forecasting purposes, a supporting rationale must be provided.

For volume and revenue estimates, and subject to rule 54(a)(2), the Postal Service is to provide:

- a detailed explanation of the methodology employed to forecast volumes for each class and subclass of mail and postal service. Representative derivations of these forecasts from the econometric demand study must be presented in detail for two major mail classes, showing each intermediate value or factor employed. For remaining classes and subclasses of mail, such derivations may be summarized, except where their derivations depart from the representative methods presented;
- a detailed explanation of the methodology employed to forecast changes in revenues for each class and subclass of mail and postal service resulting from changes in rates and fees;
- a computer implementation of the methodology employed to forecast volumes and revenues for each class and subclass of mail and postal service. The computer implementation must comply with Rule 31(k)(3), and must be able to compute forecasts of volumes and revenues compatible with those specified in Rules 54(j)(2), (3), and (5) for
 - o any set of rates and fees within a reasonable range of the prefiled (existing) and the proposed rates,
 - o any date of implementation within the range spanned by the assumed date of implementation and the start of the test year,
 - o alternative forecasts of the economic determinants of postal volumes, other than postal rates and fees, and

- o alternative values of any parameters with assigned values that are based upon unverifiable judgments.

Subject to rule 54(a)(2), the Postal Service must make available at the offices of the Commission, in a form that can be read directly by a standard digital computer, the following:

- all of the input files and programs needed to replicate the requested econometric demand study;
- any input files and programs employed to derive a price index for any class or subclass of mail or postal service from postal rates, discounts, and fees;
- any input files and programs used to prepare data for use in the requested econometric demand study.

The Postal Service requests that the requirement be waived, to the extent that it compels the development of a volume estimates beyond those provided by witnesses Ellard (USPS-T-2) and Kiefer (USPS-T-4).

RULE:54(k)

INFORMATION REQUESTED:

This rule requests that the Postal Service provide, for the two fiscal years immediately preceding the year in which the request is filed, the Balance Sheet, the Statement of Income and Expense, basic statistical information, and the Statement of Income and Expense by budget category. This includes data with respect to the following:

- (1) the Balance Sheet and a supporting schedule for each item that appears thereon;
- (2) the Statement of Income and Expense and a supporting schedule for each item appearing thereon;
- (3) as appropriate, statistical data with respect to revenue, pieces (by physical attributes, showing separately amounts of mail identified as stamped, metered, and imprinted, or other), weight, distance, postal employees (number, total payroll, productivity, etc.), postal space, post offices (number, classes, etc.), and any other pertinent factors which have been utilized in the development of the suggested rate schedule; and
- (4) the Statement of Income and Expense by cost segment.

In addition, this rule requires that the Postal Service provide a reconciliation of the budgetary information with the actual accrued costs for the most recent fiscal year. If the fiscal information for the immediately preceding fiscal year is not fully available on the date of filing, the Postal Service is required to make a preliminary or pro forma submittal, and file an updated report once the fiscal information is completed.

Financial information for FY 1997 and FY 1998 is included in Attachment D to this request. The testimony and exhibits of Dr. Kiefer (USPS-T-4) furnish other "statistical data" responsive to this rule. To the extent that the rule requires additional information, the Postal Service requests that it be waived.

RULE:54(l)(i)

REQUIREMENT:

This rule requires a statement (which can be in workpaper form) indicating for each class and subclass of mail and postal service the relevant billing determinants (e.g., the volume of mail related to each rate element in determining revenues) separately for the current rates and the proposed rates. Proposed changes in rate design and the related adjustments are to be explained in detail.

The FY 1997 billing determinants for Business Reply Mail are provided on the next page.

Business Reply Mail
Government Fiscal Year 1997

L-2

MAIL CLASS	REVENUES	PIECES
Advanced Account:		
First Class-Prebarcoded	\$10,308,606	515,430,322
First Class-Other	40,993,347	410,038,527
Priority	379,840	3,800,699
Subtotal	\$51,681,793	929,269,548
Non-Advance Account:		
First Class	\$24,010,246	54,623,750
Priority	208,077	472,900
Subtotal	\$24,218,323	55,096,650
TOTAL	\$75,900,116	984,366,198
Permits: Account 43334	\$17,966,528	
Account Fee: Account 43335	27,191,247	
Total Permit Revenue	\$45,157,774	
GRAND TOTAL REVENUES	\$121,057,890	

SUMMARY STATISTICS

Advance Account Pieces	
as Percent of Total	94.40%
Total Permits Paid	211,371
Advance Acct Permits Paid	132,640
Advance Account Revenue	\$90,147,459
Non-Advance Acct Revenue	\$30,910,431
Total Revenue	\$121,057,890

RULE:54(l)(ii)

REQUIREMENT:

This rule requires, subject to subsection (a)(2), the base year volume of third-class bulk mail by ounce increment for each shape (letter-size, flat, irregular parcels, and parcels), submitted separately for regular and preferred, by presort level.

The Postal Service requests that the requirement be waived.

RULE:54(m)

REQUIREMENT:

This rule requires a statement, which can be in workpaper form, presenting detailed calculations of continuing appropriations according to 39 U.S.C. § 2401(c) and phasing appropriations under 39 U.S.C. § 3626 and any proposed adjustment to such phased rates under 39 U.S.C. § 3627 indicated by circumstances known at the time of the filing. Calculation of all the phased rates for the entire applicable phasing period are to be explained in detail.

This rule is not applicable to this Request since there are no changes proposed to any preferred subclasses of mail.

RULE:54(n)

REQUIREMENT:

This rule requires identification of any performance goals which have been established for the classes and subclasses of mail. The Request is to identify the achieved levels of service for those classes and subclasses of mail and mail services for which performance goals have been set.

Information responsive to this Rule was provided in Docket No. R97-1.

RULE:54(o)

REQUIREMENT:

This rule requires seven sets of workpapers to be filed with the Request.

The required copies of Schenk Workpaper I are supplied with this Request to the Commission, *in camera*, subject to a Motion For Protective Conditions.

RULE:54(p)

INFORMATION REQUESTED:

This rule requests one or more certifications stating that the cost statements and supporting data submitted as part of the formal request, as well as the accompanying workpapers, which purport to reflect the books of the Postal Service, accurately set forth the results shown by such books. The requested certification is to be signed by one or more representatives of the Postal Service authorized to make such certification.

The requested certification is submitted as Attachment C to this Request.

RULE:54(q)

INFORMATION REQUESTED:

This rule requests an opinion from an independent public accountant to the extent and as required by 39 U.S.C. § 2008(e).

An opinion by the independent accounting firm of Ernst & Young covering Fiscal Years 1997 and 1998 is contained in Attachment D.

RULE:64(b)(1), (2), (3), (4)

INFORMATION REQUESTED:

These subsections request, for every classification change proposed:

- (1) copies of the currently-effective Domestic Mail Classification Schedule and the proposed changes thereto;
- (2) specification of the rules, regulations and practices that establish the conditions of mailability and standards of service;
- (3) a statement of the degree of economic substitutability between the various classes and subclasses; and
- (4) an identification of all nonpostal services.

See response to Rule 54(b).

RULE:64(c)(1), (2), (3)

INFORMATION REQUESTED:

This rule asks for information regarding the users of the Postal Service, the nature of the items mailed and the methods of mailing used. Specifically, this section requests the following:

- (1) an identification of the characteristics of the mailer and the recipient, and a description the contents of items mailed within each class and subclass;
- (2) identification of the physical attributes of the items mailed by class and subclass, including shape, weight and distance; and
- (3) to the extent it is not provided under paragraph (b)(2), a summary statement that describes special service arrangements provided to, or requested or required of, mailers by the Postal Service that affect the cost of service or its value to the mailer or recipient.

See response to Rule 54(c), (d) and (e).

RULE:64(d)

INFORMATION REQUESTED:

This rule requests that effects of the changes on cost assignments, total costs, and total revenues be provided, on a before and after change basis.

See response to Rule 54.

RULE:64(e)

INFORMATION REQUESTED:

This subsection requires that, whenever the Postal Service proposes to reassign a portion of one existing class or subclass of mail or service to another existing class or subclass of mail or service, the request must include a comparison of the before and after costs and revenues of handling the relevant classes or subclasses, and before and after costs and revenues of the portion that is to be reassigned.

This section does not apply to the current Request, which does not involve the reassignment of a portion of an existing class or subclass of mail or service to another.

RULE:64(f)

INFORMATION REQUESTED:

This rule requests a complete statement of the reasons and bases for the proposed changes.

The testimonies of witnesses Shields (USPS-T-1), Ellard (USPS-T-2), Schenk (USPS-T-3) and Kiefer (USPS-T-4) provide the reasons and bases for the proposed changes.

RULE:64(g)

INFORMATION REQUESTED:

This rule sets forth the requested format and filing requisites for workpapers.

See response to Rule 54(o).

RULE:64(h)

INFORMATION REQUESTED:

This rule calls for compliance with specified subsections of Rule 54 when the Postal Service proposes a change in the mail classification schedule having a rate, fee or total cost change implication.

The Compliance Statement provisions addressing Rule 54 are set forth above.